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Report on State support of higher education in the South. Points out that State government is largest single source of support, yet higher education takes relatively small percent of total State expenditures. Discusses a study of tax resources which offer potential sources of additional revenue. The study was prepared by Dr. James Martin, director of the Bureau of Business Research of the University of Kentucky, at the request of the Southern Regional Education Board.

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"Sources of State Support."

FROM WHERE will the educational dollar of the future come?

How much of it will the state provide?

These vital questions face the Southern state legislatures of the 60's with even more immediacy than they have in past decades of decision.

This issue of the Southern Regional Education Board's Financing series is concerned with the problems of state finance of higher education, past and future. Here are to be found answers to a few basic questions about the nature of state support of higher education in the years ahead.

How Much Support Do the States Now Supply to Colleges and Universities?

State government is currently the largest single source of support for higher education.

About 40 per cent of all the money for college and university operations—private and public—in the South comes from state government. More than half of the students in the region are enrolled in public institutions, and almost 60 per cent of the budget of public colleges comes from the states.

Very little—only about 1 per cent—of the support for private higher education comes from the states.

State appropriations for higher education in the South have increased tremendously in the last 20 years. In 1940 the states of the region appropriated 46 million dollars for current operations, while in 1958-59 they appropriated an estimated 296 million dollars.

Expressing all figures in current dollars, to take account of inflation, this is an increase from about $100 million in 1940 to $295 million in 1958—a threefold increase in 20 years.

In this same period of time, enrollment in the public colleges has increased about two and a half times, so most of the increase in financial support has been to take care of the additional students.

How Large a Part of State Appropriations Go for Higher Education?

Higher education takes a relatively small per cent of the total state expenditures. In 1940 these expenditures amounted to about 5 per cent of the budget. By 1958 they had increased to about 7 per cent of the budget. Counting capital outlay expenditures, too, they amount to about 8 per cent of the budget, a level which has been maintained for several years. (See Figure 1.)

How Much of the Citizens' Income Is Spent on Higher Education?

In 1940, just before World War II, operational expenditures for public higher education amounted to only 62¢ out of every $100 of personal income. In 1958 states still spent exactly 62¢ out of every $100. The rise in spending for public higher education has exactly paralleled the increase in income in the region.

Some legislators feel that this is the key to adequate financing of higher education in the future. In effect, their stand is this: Raise the income of the Southern people. Then the increased taxes they will pay, because of the higher income, will finance the state services we need.

Rising income will help. But the needs of higher education in the next 10 years will grow more rapidly than personal income can be expected to rise.

If the states collect the same per cent of income in taxes in the future and if they allot the same per cent of their tax revenue to higher education, the support of higher education will actually decrease on a per student basis.

College enrollments are expected to increase more rapidly than personal income in the next ten years.

In order to increase faculty salaries to make them competitive with industry and non-Southern universities, our states will have to spend 94¢ out of every $100

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personal income, in 1970 for higher education. (See Figure 2.)

Unless other demands on the state tax dollar remain static, new tax revenues for higher education will be needed.

Where Will Additional Revenues Come From?

Because the needs of higher education will grow more rapidly than the income from present tax sources, legislators have become concerned about sources of additional revenue.

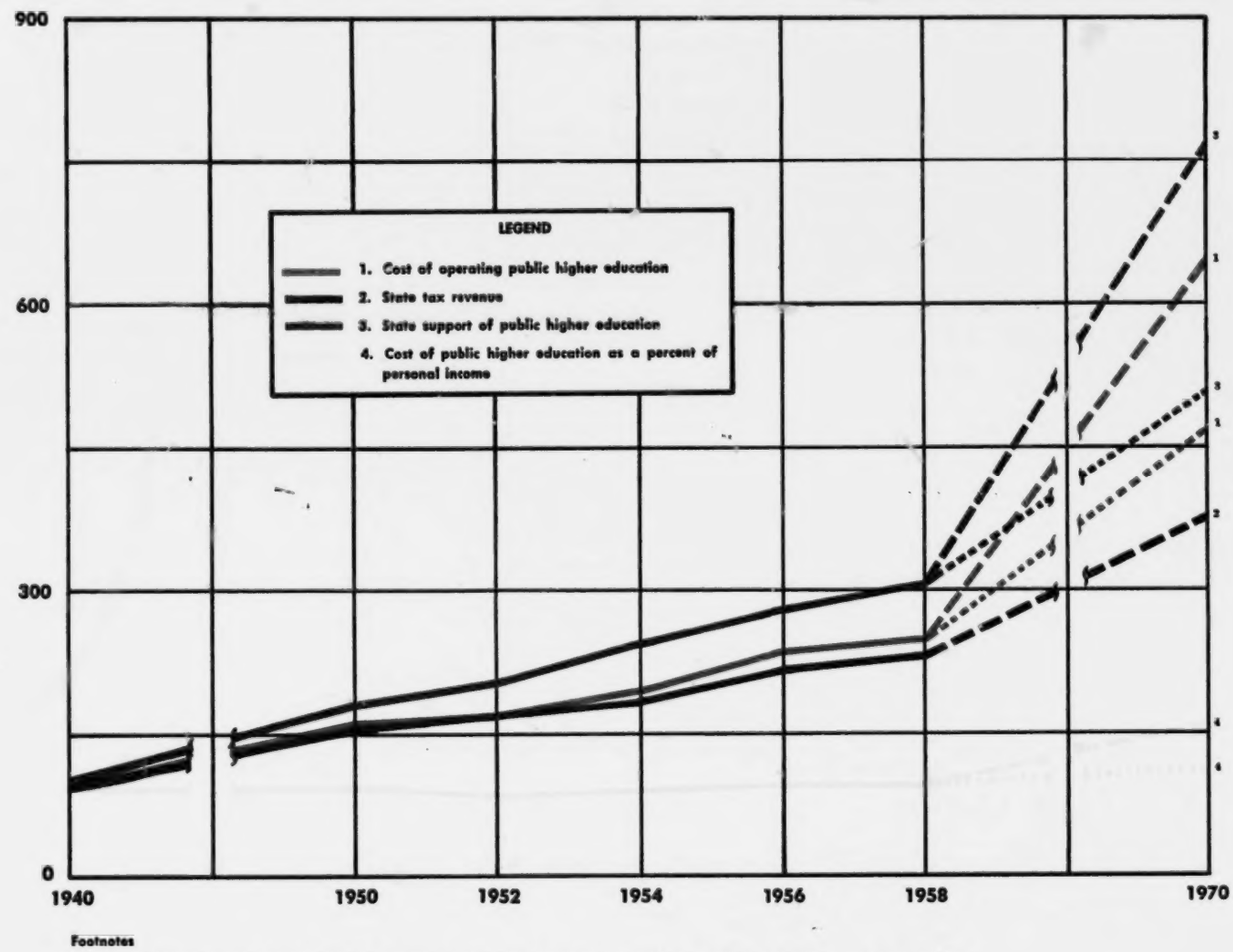
Dr. James Martin, director of the Bureau of Business Research of the University of Kentucky, at the request of the Southern Regional Education Board, has made a study of tax resources which offer potential sources of additional revenue. (Copies of his full report may be obtained from SREB.)

Dr. Martin's study does not recommend that the states employ the taxes described in his study—he suggests only that these sources are available to the states if they wanted to use them.

Dr. Martin says of the study, "This is an effort to ascertain whether there are opportunities for raising additional state-local revenue in the individual states of the SREB area. Certain types of taxes used successfully in some states are not used or are not used fully in other states. It would be possible, therefore, for a particular state to increase its total tax effort by exploiting these neglected sources of revenue."

Dr. Martin devotes major attention to four major sources of additional revenue: (1) sales and gross receipts taxes; (2) property taxes; (3) individual income taxes; and (4) corporate income taxes.

FIGURE 1.
HOW MUCH ARE WE REALLY SPENDING FOR PUBLIC HIGHER EDUCATION?



Footnotes

[1] High projection for 1970 based on 50% increase in cost per student; low projection assumes constant cost per student.

[2] Projected as a constant percent of personal income.

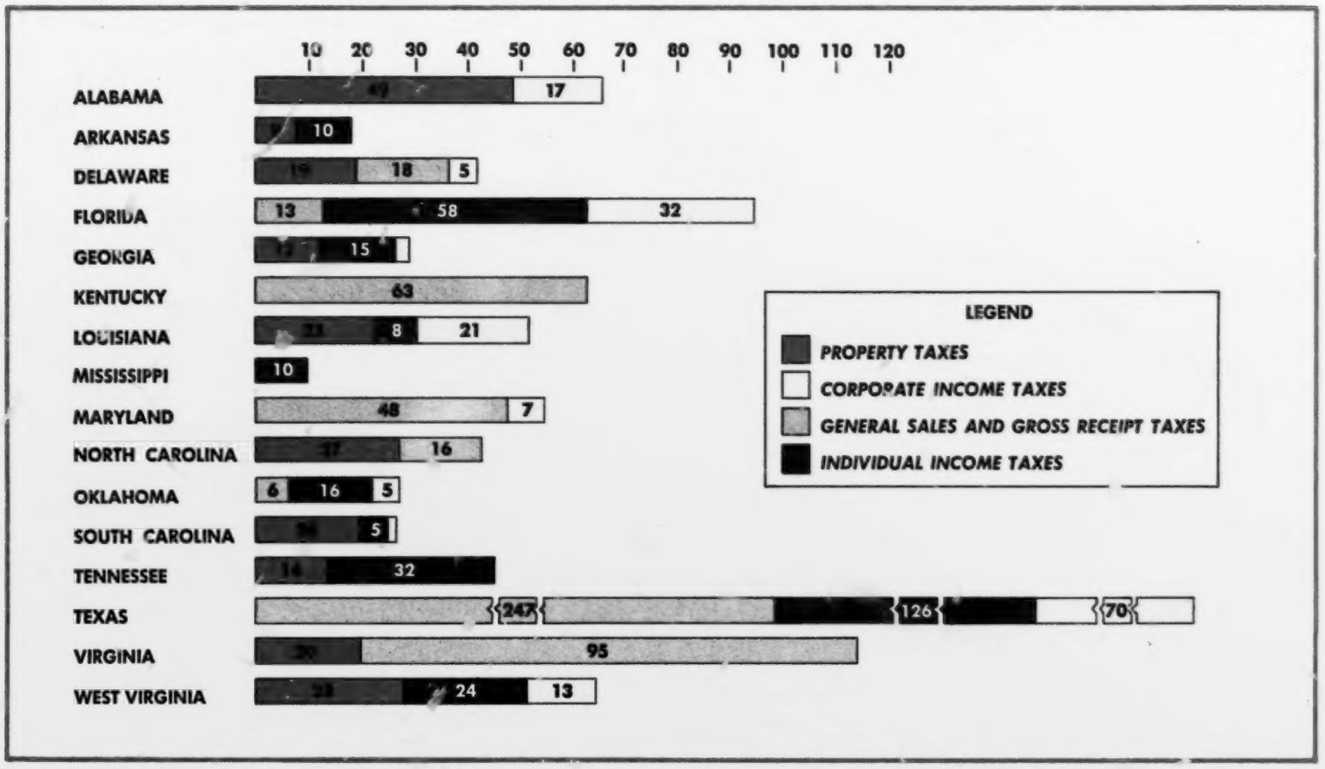
[3] High projection for 1970 based on prevailing percent of educational expenditure which is provided by the states (58%); low projection based on prevailing percent of state expenditure which goes to operation of higher education (7%).

[4] High projection based on high cost projection; low projection based on low cost projection.

1940=100

Trends in Cost of Public Higher Education and State Revenue, 16 Southern States, 1940-1970.

FIGURE 2. FOUR LARGEST UNTAPPED SOURCES OF STATE REVENUE



Major examples of unused taxable capacity in Southern Regional Education Board States (in millions of dollars).

He also analyzed other tax possibilities, but as Table 1 shows, their potential, as determined by the method used, is less.

The Revenue Picture

The Southern states could raise an additional 1½ billion dollars in revenue from existing taxes, if every state used all taxes mentioned and if every state made an "average effort" to levy each tax. (See insert for a description of the method of analysis.)

Southern states raised over six billion dollars in taxes in 1957. The additional tax possibilities indicated by Dr. Martin's analysis represent an increase of approximately 25 per cent over this figure.

This potential tax revenue is far more than the amount that will actually be needed from the states for the support of higher education in the next decade.

By 1970, the Southern states will need to provide ¾ billion dollars a year to finance growth of higher education and increase costs of education. This figure compares with $300 million required in 1958-59.

Rising income will provide about a half billion dollars by 1970, with no new taxes and no increase in the amount of each tax dollar spent for higher education.

The other quarter billion would have to come from new taxes or an increase in the share of the state tax dollar going to higher education.

This would require only about 1/6 of the states' additional tax potential to provide for the needs of higher education in the decade ahead.

Some of the SREB states would have a relatively easy task of increasing their tax revenue. For others, it would be difficult.

Texas, for example, has over one-half billion dollars of tax revenue potential since it uses neither general sales nor income taxes. Total state and local taxes are about 7.6 per cent of personal income in Texas—a percentage lower than most other Southern states.

Personal income in Texas is higher than in most other Southern states and it would be relatively easy (speaking from an economic, rather than a political, point of view) to raise additional state revenue for higher education.

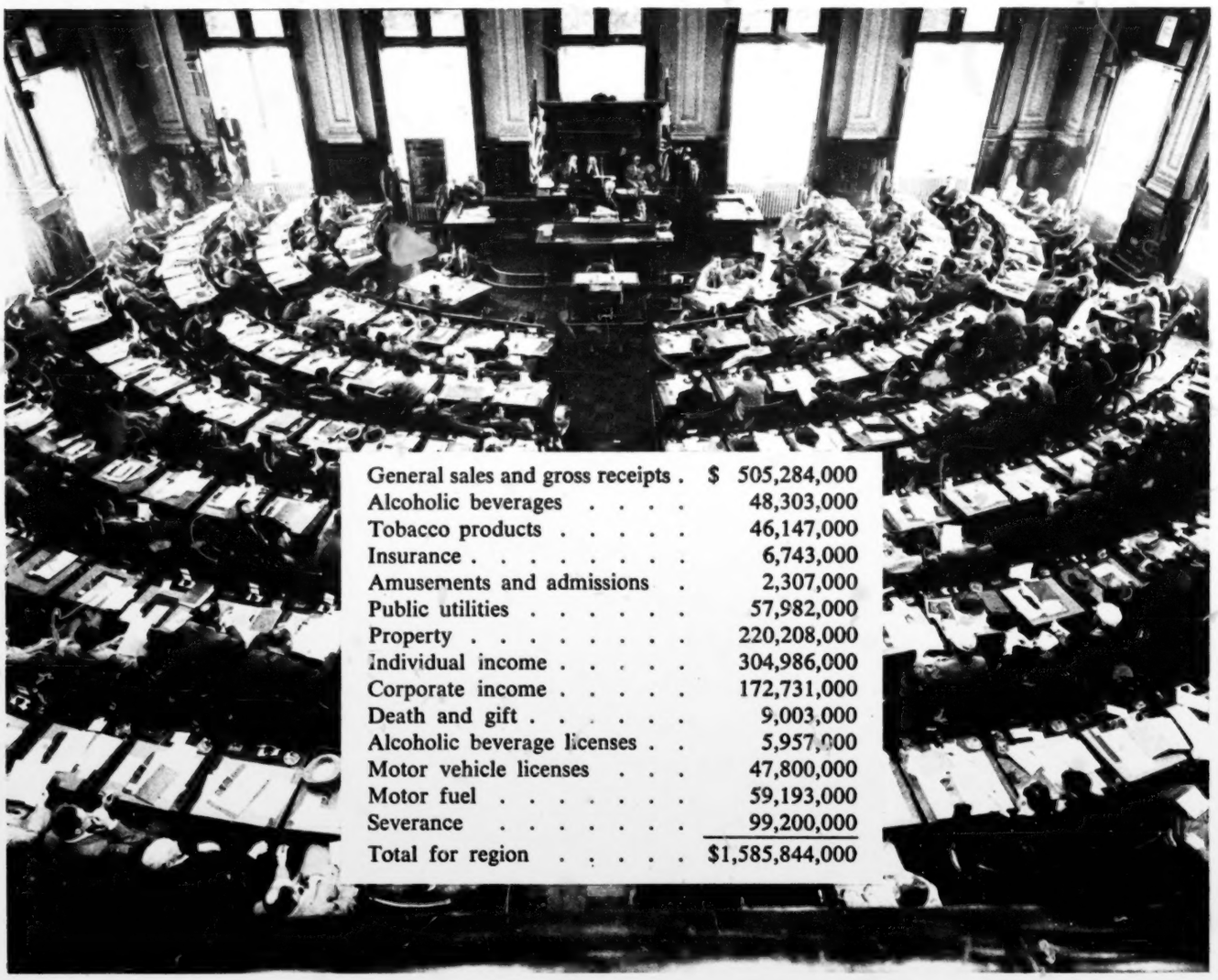
Maryland and Delaware are also in this position.

It would be relatively difficult, however, to raise additional revenue in Mississippi.

Low per capita income produces limited state revenue in Mississippi, even though the state makes the largest effort of any Southern state, with state and local taxes amounting to 11.2 per cent of personal income in the state.

TABLE 1

SUMMARY OF POSSIBLY COLLECTIBLE TAX REVENUES IN EXCESS OF AMOUNT ACTUALLY COLLECTED, 1957, 16 SOUTHERN STATES



General sales and gross receipts	$ 505,284,000
Alcoholic beverages	48,303,000
Tobacco products	46,147,000
Insurance	6,743,000
Amusements and admissions	2,307,000
Public utilities	57,982,000
Property	220,208,000
Individual income	304,986,000
Corporate income	172,731,000
Death and gift	9,003,000
Alcoholic beverage licenses	5,957,000
Motor vehicle licenses	47,800,000
Motor fuel	59,193,000
Severance	99,200,000
Total for region	$1,585,844,000

Potential new taxes in the state amount to less than 20 million dollars, according to Dr. Martin's analysis, and it will be very difficult to find additional state revenue for higher education or other purposes.

Arkansas is another state with relatively low personal income, a comparatively high effort to collect taxes and limited additional tax revenue potential.

Following is a more detailed examination of the four major sources of revenue potential.

General Sales and Gross Receipts Taxes

The greatest unrealized potential for more tax revenue is in the general sales tax—one-half billion dollars in the region as a whole.

Most of this potential would be realized by use of the tax in four states, Delaware, Kentucky, Texas and Virginia. None of these now use the tax.

Among those currently using sales taxes, some have a strictly retail sales commodity tax (Florida) or a great many exemptions (Maryland, North Carolina), so that the tax yields less than the average amount.

In half the sixteen states, general sales taxes already provide more than the average amount of income.

The general sales tax is a source of a large amount of potential revenue in the states which do not now use it, and of considerable additional revenue in other states which provide many exemptions, limited coverage, or both.

Property Taxes

State and local property taxes provide over two billion dollars' worth of revenue, more than any other tax source in the SREB states. However, most of this is local rather than state revenue. Administration, par-

ticularly assessment, of these taxes presents serious problems. All states have certain general exemptions, which narrow the tax base to some extent.

Homestead exemptions and exemptions for certain new manufacturing industries for a period of years contribute to the shortage of revenue from this source.

Arkansas, Delaware, Florida, South Carolina, and Tennessee have no state property levy; North Carolina has such a levy only on intangibles.

While state property tax revenue in most states is only a small part of revenue from such taxes, an acceptable state levy might increase the aggregate revenues in these states.

Ten of the states could collect additional property tax revenue at either state or local level if they would make an average effort. (See Figure 2.) Alabama, Louisiana, North Carolina, and West Virgina all have relatively large potential for more revenue from this source.

In the aggregate for the region, about $220 million of revenue potential exists in the property tax field.

Individual Income Taxes

The second largest source of potential revenue—over $300 million—is the individual income tax. The biggest revenue potentials of the personal income tax exist in those states (Florida, Texas, and West Virginia) where there are no income taxes, and in Tennessee where only interest and dividend income is taxed.

Some additional revenue potential exists in states like Alabama, Arkansas, Georgia, Louisiana and Mississippi where a combination of low income and large personal exemptions mean that most of the population do not pay any income tax. Eleven of the 16 SREB states could obtain some additional revenue from in-

The Method of Analyzing Tax Revenue Potentials

Dr. James W. Martin, director of the Bureau of Business Research at the University of Kentucky used the following method in analyzing tax revenue potential.

THE BASIC APPROACH was to assume that any state can use taxes which have been demonstrated by experience in other states to have been successful. Using the classification of tax methods set up by the U. S. Bureau of the Census in its comprehensive survey of state and local finances in 1957, Dr. Martin first listed the revenue received from each source in each state. This was then divided by the personal income of the people of the state for most taxes such as income, sales, etc. For a few taxes, such as severance taxes, other, more appropriate, bases were used.

This indicates the revenue from each tax source in each state as a percent of the total income in the state.

It was then assumed that any state in the South could raise as much revenue per $1,000 of income of its residents, from that source as the average Southern state did, if it wanted to. This concept of "average effort" is the central part of the analysis. For example, the states of the SREB area raised, in 1957, $411 million in state personal income taxes. This amounted to $7.67 per $1,000 of personal income in the 13 states that employed personal income taxes. (Three states in the South do not.) If Georgia, for example, had raised the average of $7.67 per $1,000 of Georgia income, its income tax revenue would have been $41 million in 1957, instead of $26 million it actually collected. Thus Georgia is represented as having a "potential" of $15 million more from personal income taxes if it came up to the average personal income tax effort in the Southern states.

This analysis ignores political and legal problems connected with the levying of any tax in any state. It is an economic analysis, and leaves up to the states the problem of deciding what is a "good" or "bad" public tax policy.

It also does not consider the extent to which a tax may be "too low" or "too high" in all states. For example, many people feel that property taxes in general are "too low." The data assembled by Dr. Martin do not attempt to answer this question, and the $220 million shown in Table 1 as additional revenue possible in the Southern states from the property tax, just indicates how much more would be raised if all states came up to Southern average.

It does not indicate at all whether the average is too low or too high.

A full description of Dr. Martin's method and detailed figures for each state are included in his complete report, copies of which are available from the Southern Regional Education Board.

dividual income taxes, if they made an average effort in this tax field. (See Figure 2.)

Corporate Income Taxes

Corporate income taxes provide about $170 million of additional revenue potential, again, mostly in the states which do not use this source of revenue now (Delaware, Florida, Texas and West Virginia).

Alabama and Louisiana make only limited use of these taxes. In some states the low yield from this tax is related to limited industrialization, but it appears to be related to exemptions, too. Alabama, Kentucky, Louisiana, and Oklahoma allow deduction of the federal corporate tax, which has the effect of cutting the tax base in half in these states. Eleven of the 16 states could raise more revenue from this source if they made an average effort.

Summary

1. Tax effort in the Southern Regional Education Board states has varied widely in respect to particular revenue measures. Most states direct their major efforts toward one or a few methods of taxation while completely ignoring or putting less than average emphasis on other taxes. By exerting more effort along these neglected lines increased revenues are possible.

2. The states utilizing heavily only one or two methods of taxation must rely more heavily upon them than if the same states diversified their tax systems. Choices have to be made among alternative tax policies. State and local situations may make it impracticable in some cases to bring tax revenues up to the standards outlined.

3. If the approach employed by Dr. Martin is sound, some states have diversified their tax bases to a lesser extent than have the average of SREB states.

All these states can find added sources of revenue by applying more extensively one or more of the proved revenue sources discussed above.

4. In further extending tax effort along particular lines, the states must consider total tax loads on the taxpayers.

As measured against income in the state, Alabama, Delaware, Florida, Kentucky, Maryland, Texas, Virginia, and West Virginia now impose a less-than-average tax load. This suggests that the states named, in particular, could readily exploit available tax sources more fully than could the others. A few states (especially Mississippi and Arkansas) rank high in tax "burden." It would be measurably more difficult, economically speaking, for these states to take advantage of the particular taxes in which it has been shown that they have exerted less-than-average effort.

5. From an economic point of view this analysis indicates that it would be relatively easy to raise the quarter billion dollars of additional state revenue needed by 1970 for the support of higher education from tax sources already being used in the states. In some states the job would be much easier than others, and in a few it may be very difficult.

The main problem facing adequate support of higher education is a political one—do the people want higher education supported from state tax moneys at a more adequate level?

Are they willing to levy the additional taxes?

Will the legislators be responsive to the wishes of the people about higher education even if it means the ever unpopular increase in taxes? These are big questions which the states must face.

Dr. Martin's paper can help guide a search for the best possible decision, but the answers to the question must come from the legislators, and ultimately, from the public.

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